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FACT SHEET

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REALESTATEMENT: NEW TAX PROVISIONS FOR SALE OF PRINCIPAL RESIDENCE BY HOMEOWNERS AGE 55 OR OVER

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With changing family and social needs, many older adults discover that their housing needs have altered and that a smaller residence is desirable. Still others have faithfully made mortgage payments in hope that the sale of the residence will provide funds for retirement dreams. However, rapid rises in selling prices have resulted in unfavorable tax consequences (i.e., sizable gains) for those homeowners who elected to relocate or liquidate. The Revenue Act of 1978 substantially alters one method designed to ease the tax burden when a home is sold and liberalizes another method. New provisions pertaining to the sale or exchange of a taxpayer's principal residence took effect July 27, 1978.

Before the Act, the sale of a residence was considered a regular taxable capital transaction unless either of two exceptions was met. The new tax law provisions expand these exceptions. For residence sales occurring on or after July 27, 1978, individual taxpayers who are 55 or older are allowed to exclude from gross taxable income up to $100,000 of any realized gain from the sale or exchange of a principal residence ($50,000 for married individuals who file separate returns). However, this option can be exercised only once in a lifetime. To qualify, the taxpayer *must have owned and occupied* the property as a personal residence for three or more years during a five-year period ending on the date of sale or exchange. A taxpayer age 65 or older who makes a sale or exchange before July 26, 1981 will also qualify if the taxpayer *owned and occupied* the property as a personal residence for five or more years during an eight-year period ending on the date of sale or exchange.

Since the exclusion election may be used only once in a lifetime, this provision has important implications for married taxpayers who make such an election during a marriage which later is dissolved by divorce. Remarriage will not reinstate the election for either spouse, regardless of any events occurring subsequent to a divorce.

The other exception applies to homeowners of any age and pertains to the sale or exchange of a personal residence when another residence is purchased within 18 months. Prior tax law maintained that the entire gain could be deferred in these situations as long as the new residence cost at least equaled the adjusted sales price of the old residence and the taxpayer maintained the new residence as his or her principal residence for at least 18 months. While essentially preserving prior law, the new law permits more than one tax deferred "rollover" within 18 months under the conditions the taxpayer relocates for employment purposes and reinvests in another residence as described above. The same standards as are currently in effect concerning deductibility of moving expenses will be used to determine whether the sale is caused by a change of employment location.

The Revenue Act of 1978 also permits taxpayers to utilize the once-in-a-lifetime election in conjunction with the above stated reinvestment provisions. That is, any gain that would otherwise be recognizable after reinvestment of only part of the residential sale proceeds can be excluded from taxation by the new one-time election (see Case B, Table 1). This provision permits homeowners 55 or over to "step down" in the housing market without incurring an unfavorable tax burden.

Three examples of the new tax provision's impact are provided in Table 1. Case A illustrates a situation where the $100,000 exclusion was unnecessary for tax deferral since the purchase price of the new residence exceeded the adjusted sales price of the old resi-

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dence. Cases B and C illustrate impact of the $100,000 exclusion on tax deferral and tax basis of a new residence. Note that the taxpayer in Case B has elected to use the $100,000 exclusion to exclude $74,000 gain. The taxpayer *cannot* exercise this election again, even though less than $100,000 was excluded in this transaction. (Sales price of $160,000 illustrates full impact of new provisions; the average homeowner's tax benefit will be commensurate with sales proceeds.)

The Act eliminates gains on personal residential sales as a tax preference item for both the regular minimum tax and the new alternative minimum tax. This particular provision is effective for sales occurring after October 31, 1978 regardless of whether the above mentioned exceptions apply.

Homeowners of age 55 or over should consider these tax-saving methods when selling a principal residence and buying another (including a condominium). Every homeowner/taxpayer is in a unique tax situation. This publication should not be used for making final tax decisions, nor should it be regarded as offering a complete explanation. Thus, expert tax advice is strongly recommended in all tax decisions and tax planning.

Table 1. Impact of One-Time $100,000 Gain Exclusion Election from Sale of Principal Residence

1. Sales Price of Old Residence	$160,000
2. Minus Selling Expenses	10,000
3. Amount Realized	$150,000
4. Minus Fixing-up Expenses	1,000
5. Adjusted Sales Price of Old Residence	$149,000
6. Tax Basis of Old Residence	35,000
7. Gain Realized (Line 3 minus Line 6)	$115,000

Assumed Purchase Price of New Residence	Case A $150,000		Case B $75,000		Case C $25,000	
	Sale Without One-Time Election	Sale With One-Time Election	Sale Without One-Time Election	Sale With One-Time Election	Sale Without One-Time Election	Sale With One-Time Election
8. Adjusted Sales Price of Old Residence	$149,000	$149,000	$149,000	$149,000	$149,000	$149,000
9. Minus Purchase Price of New Residence	150,000	150,000	75,000	75,000	25,000	25,000
10. Gain Recognized for Tax Purposes Without One-Time Election	-0-	-0-	74,000	74,000	115,000*	115,000*
11. Gain Excluded Under One-Time Election		unnecessary		74,000		100,000
12. Gain Recognized For Tax Purposes With One-Time Election		-0-		-0-		$ 15,000
Tax Basis of New Residence**						
13. Fair Market Value of New Residence	$150,000	$150,000	$ 75,000	$ 75,000	$ 25,000	$ 25,000
14. Minus Amount of Gain Realized But Not Recognized for Tax Purposes (Line 7 minus Line 10)	115,000	115,000	41,000	41,000	-0-	-0-
15. Tax Basis of New Residence	$ 35,000	$ 35,000	$ 34,000	$ 34,000	$ 25,000	$ 25,000

* Gain Recognized cannot exceed Gain Realized.
**Use of One-Time Election does not affect the New Residence Tax Basis Computation.

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5M — 7-79, Reprint RD